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Constitutional Law -- Bankruptcy -- Municipal Corporations

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as it is well known that in most instances in recent years the legal rate has not been realized on funds, and the plaintiff's damages probably did not amount to more than the two per cent allowed. Also as the defendant acted in good faith and had apparent grounds for the refusal of the plaintiff's demand for payment, the bank, its depositors and creditors should not be penalized by having to pay the legal rate of interest as damages.

C. M. IVEY, JR.

Constitutional Law—Bankruptcy—Municipal Corporations.

Congress in 1934, by the Sumners-Wilcox Municipal Debt Readjustment Act,¹ amended the Federal Bankruptcy Act² to permit any municipality or other political subdivision of any state to obtain a voluntary readjustment of its debts through proceedings in the Federal courts. A Texas water improvement district, claiming to be insolvent and unable to meet its debts as they matured, petitioned the United States District Court for a readjustment under the Sumners Act.³ The Texas legislature in the meantime granted political subdivisions the express right to proceed under the Federal law.⁴ The United States Supreme Court held the act invalid as an unconstitutional encroachment upon state sovereignty over the fiscal affairs of local governmental units,⁵ regardless of the express consent of the state.

The majority of the court felt that as the power "to establish uniform Laws on the subject of Bankruptcies" and the power "to lay and collect taxes" were both granted in Article I, section 8 of the Constitu-

Lowden v. Iowa-Des Moines Nat. Bank and Trust Co., 10 F. Supp. 430 (S. D. Iowa 1935); Coral Gables Inc. v. Patterson, 166 So. 40 (Ala. 1936); Reif v. Barrett, 355 Ill. 104, 188 N. E. 889 (1933); Chicago Title and Trust Co. v. Chicago Trust Co., 1 N. E. (2d) 87 (Ill. 1936); Bolivar Tp. Board of Finance of Benton County v. Hawkins, 207 Ind. 171, 191 N. E. 158 (1934); United Shoe Stores Co. v. Burt, 142 So. 370 (La. 1932); Campbell v. City of Boston, 195 N. E. 802 (Mass. 1935); Shonnard v. Elevator Supplies Co., 111 N. J. Eq. 94, 161 Atl. 684 (1932); Williams v. Williams, 12 N. J. Misc. 641, 174 Atl. 423 (1934); Kuhn v. Cermac Realty Co., 148 Misc. 324, 265 N. Y. Supp. 861 (1933); *In re Connelly's Estate*, 151 Misc. 310, 271 N. Y. Supp. 368 (1934); *State ex rel. Zimmerman v. Gibbs*, 171 S. C. 209, 172 S. E. 130 (1933); *Dukes v. Jefferson Standard Life Ins. Co.*, 172 S. C. 502, 174 S. E. 463 (1934).

¹ 48 Stat. 798, 11 U. S. C. A. §§301, 303 (1934).

² 30 Stat. 554 (1898), 11 U. S. C. A. §1 *et seq.* (1927).

³ *In re Cameron County Water Improvement Dist. No. 1*, 9 F. Supp. 103 (D. C. Tex. 1934) (petition denied for lack of jurisdiction). *Contra*: *Cameron County Water Improvement Dist. No. 1 v. Ashton*, 81 F. (2d) 905 (C. C. A. 5th, 1936); *In re East Contra Costa Irrigation Dist.*, 10 F. Supp. 175 (D. C. Cal. 1935); *In re Imperial Irrigation Dist.*, 10 F. Supp. 832 (D. C. Cal. 1935), Note (1936) 34 MICH. L. REV. 731; see *Carteret County v. Sovereign Camp, Woodmen of the World*, 78 F. (2d) 337 (C. C. A. 4th, 1935).

⁴ TEX. LAWS (1935) c. 107.

⁵ *Ashton v. Cameron County Water Improvement Dist. No. 1*, 56 Sup. Ct. 892, 80 L. ed. adv. op. 910 (1936) (5-4 decision).

tion, they should be limited equally. Therefore, since the Federal Government cannot tax the states,⁶ neither can it interfere with a state's sovereignty by the exercise of the bankruptcy power.

The court's viewpoint of an infringement on states' rights seems untenable. The Act specifically provides against any interference with states' rights⁷ because: (1) the governmental units may not act except by a voluntary petition;⁸ (2) this petition must have the written approval of the state agency if one has been created to handle municipal insolvency problems;⁹ (3) the Federal judge must approve the plan of readjustment.¹⁰ This element of consent would seem to remove the objection of interference with states' rights since either government may tax the other if consent is given,¹¹ and a state may even interfere with interstate or foreign commerce with consent of the Federal government.¹² Therefore if consent will validate a taxation burden there should be no objection to a beneficial debt readjustment privilege.¹³ Fear of a future extension so as to amount to an encroachment is completely obliterated by judicial review of the Supreme Court.¹⁴

It was thought that the Act would be attacked upon the ground that municipalities are not the proper subject of bankruptcy,¹⁵ there being no distributable assets, as property used for governmental purposes is not subject to attachment and private property of citizens may be reached only by taxation. However, distributable assets have been deemed unnecessary in the past,¹⁶ and recent opinions appear to support this view.¹⁷ Nor is the Act hostile to the nature of bankruptcy

⁶ *Collector v. Day*, 78 U. S. 113, 20 L. ed. 122 (1870); *cf. McCulloch v. Maryland*, 17 U. S. 316, 4 L. ed. 579 (1819) (states cannot tax instrumentalities of Federal Gov't).

⁷ 48 Stat. 798 §80(k), 11 U. S. C. A. §303(k) (1934).

⁸ 48 Stat. 798 §80(a), 11 U. S. C. A. §303(a) (1934).

⁹ 48 Stat. 798 §80(k), 11 U. S. C. A. §303(k) (1934).

¹⁰ 48 Stat. 798 §80(a), 11 U. S. C. A. §303(a) (1934).

¹¹ *Baltimore National Bank v. State Tax Comm.*, 297 U. S. 545, 56 Sup. Ct. 417, 80 L. ed. 588 (1936); *United States v. California*, 297 U. S. 175, 56 Sup. Ct. 421, 80 L. ed. 367 (1936).

¹² *Wilkerson v. Rahrer*, 140 U. S. 545, 11 Sup. Ct. 865, 35 L. ed. 572 (1891); *James Clark Distilling Co. v. Western Maryland Railroad Co.*, 242 U. S. 311, 37 Sup. Ct. 180, 61 L. ed. 326 (1917); *Whitfield v. Ohio*, 56 Sup. Ct. 532, 80 L. ed. 527 (1936).

¹³ (1935) 83 UNIV. OF PA. L. REV. 920.

¹⁴ (1936) 34 MICH. L. REV. 1252, 1254.

¹⁵ The Court assumed "for this discussion that the enactment is adequately related to the general subject of bankruptcies." But see Briggs, *Shall Bankruptcy Jurisdiction be Extended to Include Municipalities and Other Taxable Subdivisions?* (1933) 19 A. B. A. J. 637; GLENN, *LIQUIDATION* (1934) §419.

¹⁶ See *Vulcan Sheet Metal Co. v. North Platte Valley Irrigation Co.*, 220 Fed. 106, 108 (C. C. A. 8th, 1915).

¹⁷ See: *In re Bradford*, 7 F. Supp. 665 (D. Md. 1934); *In re Radford*, 8 F. Supp. 489 (W. D. Ky. 1934), *rev'd by Louisville Joint Stock Land Bank v. Radford*, 295 U. S. 555, 55 Sup. Ct. 854, 79 L. ed. 1593 (1935), but on grounds of

by providing for a composition agreement¹⁸ because composition was specifically granted by the bankruptcy act of 1867 and is available in our existing statute.¹⁹ Therefore it would appear that the exclusion of municipalities in past bankruptcy legislation has been for reasons other than any inherent disability of the municipality.²⁰ As Mr. Justice Cardozo explains in his vigorous dissent, the concept of the field to be included within the term "Bankruptcy" has been a growing one, and "the act for the relief of local governmental units is a stage in an evolutionary process which is likely to be misconceived unless regarded as a whole."²¹

The situation which gave rise to the passage of the Sumners Act was and still is a serious one. Commencing with the collapse of the Florida "boom" in 1926 there has been an ever increasing number of municipal defaults in recent years. There were approximately 2,600 taxing districts, in 41 states, in default on November 1, 1934. Their aggregate defaults represented about 10 per cent of the total indebtedness of states and their local units.²² The result was that local taxing agents were being subjected to continuous mandamus actions to compel them to tax and tax again to pay off creditors. This in turn was having a detrimental effect upon the credit of solvent taxing agents. Numerous schemes of voluntary refunding were devised and tried by the local governments with varying degrees of success. Also many states passed special legislation in an attempt to effectuate an adequate remedy. None were very successful because the Constitution expressly prohibits the States from passing any law impairing existing contracts. Federal action under the express constitutional power to enact bankruptcy legislation was necessary to avoid this constitutional restriction. There was little hope of a composition by consent of creditors as a mi-

violation of due process clause of U. S. Constitution. Insolvency is not a necessary factor for bankruptcy jurisdiction. *In re Foster Paint and Varnish Co.*, 210 Fed. 652 (E. D. Pa. 1914); *George M. West Co. v. Lea Brothers and Co.*, 174 U. S. 590, 19 Sup. Ct. 836, 43 L. ed. 1098 (1899).

¹⁸ *In re Reiman*, Fed. Cas. No. 11, 673 (D. C. N. Y. 1874); *aff'd*. No. 11, 675 (C. C. S. D. N. Y. 1875).

¹⁹ 30 Stat. 554 (1898), 11 U. S. C. A. §§30, 32 (c.) (1927).

²⁰ *In re Landquist*, 70 F. (2d) 929 (C. C. A. 7th, 1934); 7 REMINGTON, BANKRUPTCY (4th ed. 1935) §§3155.19, 3155.01.

²¹ *Ashton v. Cameron County Water Improvement Dist. No. 1*, 56 Sup. Ct. 892, 898, 80 L. ed. adv. op. 910, 916, 917 (1936). For a history of the bankruptcy clause see: WARREN, BANKRUPTCY IN THE UNITED STATES (1935) 9; (1932) 17 MARQ. L. REV. 163; *Louisville Joint Stock Land Bank v. Radford*, 295 U. S. 555, 587, 588, 55 Sup. Ct. 854, 862, 79 L. ed. 1593, 1603, 1604 (1934); *Continental Ill. National Bank and Trust Co. v. Chicago Rock Island and Pacific Railroad*, 294 U. S. 648, 667, 55 Sup. Ct. 595, 602, 79 L. ed. 1110, 1123 (1935).

²² 18 PUB. MANAG. 178 (1936); 24 NAT. MUN. REV. 32,335 (1935); *Hearings Before a Subcommittee of the Committee on the Judiciary on S. 1868 and H. R. 5950*, 73d Cong., 2nd Sess. (1934) 12.

nority group of bondholders would invariably refuse to accept a new arrangement. The Sumners Act remedied this by making recalcitrant holders accede to the plans of the majority.

Undoubtedly, governmental units actually petitioning the courts under the Municipal Debt Readjustment Act would, because of the publicity gained thereby, have their immediate future credit injured. But in the majority of cases the Act would not have to be used. The greatest value of the Act was that its presence would serve as a "persuasive influence" with which to threaten minority bondholders into agreement, thus making actual court action a last resort in extreme cases.²³

Since the Court has denied a petition to rehear,²⁴ a solution to the problem must be found through legislative action by the respective states. A few have enacted measures to deal with the problem. A summary of the action taken by the various states is given in "Legislation and Municipal Debt" in the *American Bar Association Journal*.²⁵

New Jersey²⁶ authorized readjustment procedure through the state supreme court. On a petition of the bondholders to the court stating that the municipality has defaulted, a Justice, if satisfied as to the default, may file an order to that effect, after which the municipality may seek the aid of the Municipal Finance Commission in refunding. The Commission then takes charge of the finances of the municipality until the indebtedness is within all statutory limits.

Oregon²⁷ also provides for control over defaulting municipalities by court action. Holders of defaulted obligations may petition the county court, which, with the consent of the municipality, appoints an administrator who takes over the financial affairs of the local unit. Refunding or liquidating plans must be approved by the court.

In Connecticut²⁸ when a municipality defaults on relief bonds, the State Emergency Relief Commission may apply to the superior court for the appointment of a receiver to have complete control of the financial affairs of the municipality.

Massachusetts,²⁹ on three occasions, has passed statutes which placed the finances of three defaulting municipalities in separate state commissions, the members of which were appointed by the Governor.

²³ For a report of the action taken under the Sumners-Wilcox Act throughout the United States see: 25 NAT. MUN. REV. 328 (1936).

²⁴ Ten states through their respective Attorneys General filed a brief as *amici curiae* in support of a petition for a rehearing by the Supreme Court. 4 U. S. Law Week 1 (1936). Petition for rehearing denied, 57 Sup. Ct. 5 (1936).

²⁵ 21 A. B. A. J. 370 (1935); Meriwether v. Garrett, 102 U. S. 472, 26 L. ed. 197 (1880) (action taken by Tennessee in 1877).

²⁶ N. J. LAWS (1931) c. 340, S. B. §365.

²⁷ ORE. LAWS (1933) c. 433, p. 1.

²⁸ CONN. GEN. STATS. (Supp. 1933) c. 32a, part II.

²⁹ MASS. ACTS 1931 c. 44; ACTS 1932 c. 223; ACTS 1933 c. 341.

Virginia³⁰ has a harsh law for defaulting counties. It allows the Governor, upon petition by the bondholders, to order the state comptroller to withhold payments to the county of state funds (except school funds) until the default is overcome.

Montana³¹ provides for refunding if the refunding plan is approved by the state examiner.

The default problem in North Carolina³² has been handled through the Local Government Commission which advises and aids local units in drafting refunding plans.

If neither Federal nor State action alone can solve this problem adequately, it has been suggested that a desirable result might be reached by making their legislation complementary. Through the "full faith and credit" clause "Congress might exercise its bankruptcy power by an act which would recognize the validity of state adjudications and state discharges wherever the jurisdiction of Congress extends."³³

All of the above legislation has been an attempt to remedy the evil after it has come into existence. The state legislatures should prevent the formation of this evil in the future by enacting strict measures which would prevent local governmental units from burdening themselves during "boom" periods with excessive and unnecessary bonded indebtedness.

W. C. Holt.

Constitutional Law—Minimum Wage Legislation.

The United States Supreme Court in a 5-4 decision¹ recently declared unconstitutional a New York minimum wage statute² for women. The Court based its conclusion entirely upon the case of *Adkins v. Children's Hospital*,³ which banned an attempt of Congress to regulate wages for women in the District of Columbia as an "unconstitutional interference with the freedom of contract included within the guaranties of the due process clause of the Fifth Amendment."

³⁰ VA. LAWS (1932) c. 148.

³¹ MONT. LAWS (EXTRA SESSION 1933) c. 6.

³² In North Carolina over 250 local units have defaulted in the last six years. (1936). 25 NAT. MUN. REV. 323. There are at present 24 counties and 98 cities and towns in default, 3 POP. GOV'T 16 (1936).

³³ (1935) 22 VA. LAW REV. 39; (1936) 45 YALE L. J. 702 (discussing comity by the Federal Courts to state statutory receiverships of defaulting municipalities).

¹ *Morehead v. People of New York*, 56 Sup. Ct. 918, 80 L. ed. Adv. op. 921 (1936).

² N. Y. CONS. LAWS (Cahill's, Cum. Supp. 1931-1935) c. 32, §§550-567. Statute set up a wage board to conduct investigations concerning wage payment and to determine minimum wages in certain industries upon proof that the employee was being paid an "oppressive wage." An oppressive wage was defined as one "less than the fair and reasonable value of the services rendered and less than sufficient to meet the minimum cost of living necessary for health." Violation of this act was punishable by fine, imprisonment, or both.

³ 261 U. S. 525, 43 Sup. Ct. 394, 67 L. ed. 785 (1922).